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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
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Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation	))))	CC Docket No. 94-1

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GTE's COMMENTS

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2. GTE suggests the Commission should decide to apply to VDT only as much regulation as necessary; and should restructure its regulatory program based on this principle. Apart from assuring no cross-subsidy -- which is easily done with regulatory tools already in the FCC's hands -- the Commission can best carry out its task by applying to VDT providers the equivalent of nondominant "streamlined regulation."

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GTE's COMMENTS

GTE Service Corporation and its affiliated domestic telephone operating companies ("GTE") hereby offer comments on the Commission's Further Notice of Proposed Rulemaking (the "*Further Notice*" or "*FNPRM*"), FCC 95-49 (released February 15, 1995), in the proceeding captioned above with reference to the regulation of video dialtone ("VDT") service offered by Local Exchange Carriers ("LECs" or "exchange carriers").

DISCUSSION

I. THE COMMISSION WOULD BEST CARRY OUT ITS TASK BY APPLYING TO VDT PROVIDERS THE EQUIVALENT OF "STREAMLINED REGULATION."

1. Given the reality of VDT providers as struggling market entrants, VDT regulation should not be more burdensome than that which applies to cable television firms and AT&T.

Reading the Further Notice in light of the *VDT Reconsideration Order*,[1] there are disturbing implications. Entirely proper is an expressed interest in making sure VDT

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[1] *See* Telephone Company-Cable Television Cross Ownership Rules, CC Docket No. 87-266 ("*D. 87-266*") and RM-8221, Second Report and Order, 7 FCC Rcd 5781 (1992) ("*VDT Second Report*"), *appeals pending sub nom.* Mankato Citizens Tel. Co. v. FCC, No. 92-1404 (D.C. Cir. September 9. 1992), Memorandum Opinion and Order on Reconsideration, FCC 94-269 (released November 7, 1994) ("*VDT Reconsideration Order*").

offerings are not cross-subsidized by other LEC offerings. Discussed *infra* are simple means of assuring this outcome. But the proposals of the Further Notice appear to have mixed up the roles being played by the various parties.

An exchange carrier seeking to furnish VDT in competition with a well-established cable television firm is in no sense a monopolist. Indeed, such a LEC must face the challenges and bear the burdens of a struggling market entrant. To no less a degree than Competitive Access Providers ("CAPs") today or Interexchange Carriers ("IXCs") a dozen years ago, an exchange carrier that would compete with an established cable operation is an outsider seeking to break into a well-established market.

In approaching the question of how to regulate the furnishing of VDT, it should be asked at the outset what process of rational analysis would place on a VDT provider struggling to break into a market heavier burdens than apply to long- and well-established providers, *i.e.*, cable television firms. Surely this should form the first benchmark in approaching this matter: that regulation of a VDT provider should be no more burdensome -- indeed, should be less burdensome -- than that which applies to the cable television firm already established in that market.

Furthermore, price regulation may be eliminated altogether for cable firms if competition reaches certain levels.[2] It is a supreme irony that a VDT offering may allow the established cable firm to escape rate regulation entirely even while the VDT offering is being subjected to burdensome regulation. The established firm will not only be able

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[2] *See* 47 U.S.C. Sections 543(a)(2) and 543(l)(1).

to respond to competitive challenges immediately; it will be able to initiate competitive rate changes knowing the new entrant's response will be delayed and perhaps obstructed by regulatory barriers. This is indeed a curious notion of how to employ the force of competition to bring down cable rates.

A second benchmark concerns FCC regulation of AT&T.[3] The market share in the hands of VDT providers is initially zero. **They will have to fight to capture any of the market.** Yet the extent of regulation of VDT offerings implied by the *Further Notice* would go far beyond that which applies to the commercial services of AT&T, the most powerful and dominating carrier in the country and a carrier that operates free of consent decree restrictions. The proposed VDT regulation would far exceed this regulation of AT&T even though AT&T still dwarfs all other competitors. A second benchmark in approaching regulation of VDT is it should not be more burdensome -- or even as burdensome -- as that which applies to AT&T.

In summary: For a company seeking to furnish VDT in a market where a cable firm is already established, GTE suggests two benchmarks: (i) regulation should be less burdensome than that which binds cable television firms; and (ii) regulation should be less burdensome than that which binds AT&T.

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[3] *See Revisions to Price Cap Rules for AT&T Corp.*, Report and Order, CC Docket 93-197, FCC 95-118 (released January 12, 1995) ("*AT&T Price Cap Report and Order*").

2. In light of the intensely competitive environment VDT providers will face wherever there exists an established cable firm, the Commission's policy should be to impose no more regulation than necessary.

As expressed in the *VDT Reconsideration Order* and proposed in the *Further Notice*, the FCC is moving to apply to VDT a form of price cap regulation.[4] Here it should be stressed that price caps -- which was designed to escape the inefficiencies of traditional regulation[5] -- should lead to the reduction and eventual elimination of regulation in order to make possible the best of all outcomes in the public interest, which is an unfettered and completely competitive market.[6] Thus, the Commission has expressed its intent "to remove services from price caps and place them under streamlined regulation when the record indicates that the services are in fact subject to competition."[7] Since, as noted *supra*, a VDT provider seeking to compete with an established cable firm is already facing established and most formidable competition, the record indicates that the furnishing of VDT is "in fact subject to competition."

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4 Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313 ("*D. 87-313*"), Second Report and Order, 5 FCC Rcd 6786 (1990) ("*LEC Price Cap Order*"), *modified on recon.*, 6 FCC Rcd 2637 (1991) ("*LEC Price Cap Reconsideration Order*").

5 The deficiencies of rate of return regulation were spelled out by the Notice of Proposed Rulemaking in *D. 87-313*, 2 FCC Rcd 5208, 5211 (1987). They include: (1) discouraging efficient investment; (2) encouraging cost-shifting in a competitive marketplace; (3) providing little profit incentive for the introduction of new and innovative services; and (4) denying the FCC the information it needs to make a reasoned determination about the long-term viability of competition.

6 The price cap plan is a "transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary." *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1 ("*D. 94-1*"), FCC 95-132 (released April 7, 1995) ("*LEC First Report and Order*") at para. 1.

7 *Id.* at para. 406, *footnote omitted.*

A paradigm of deregulation through price caps is the transition of AT&T regulation from the "dominant" type to the minimal regulation of AT&T existing today. In seeking to break into a market already occupied by a cable firm serving one hundred percent of the cable customers, a provider of VDT has immeasurably less market influence than AT&T has today. Consequently, as a struggling market entrant, the VDT provider should under the paradigm not have to face detailed and exhaustive regulation.

And yet, while the *Further Notice* contains some suggestion of an intent to apply more simplified regulation to VDT and make more of an allowance for freedom of action on the part of its providers,[8] it proposes a regulatory approach that would operate in a very different spirit. It would create an upside-down regulatory picture where solidly established and highly profitable firms will be "protected" from competition by new entrants.

This is strange behavior in light of the public outcry that led to Congressional action against what was perceived to be overcharges and abuses on the part of the cable television industry.[9] And it is strange behavior in light of the Commission's original intent in fashioning the VDT concept as a viable competitive alternative to monopolistic cable television. In respect of telecommunications services, exchange carriers object to asymmetric regulation that imposes heavy burdens on established carriers while leaving their competitors essentially free of regulation. Here, the heavier

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[8] *FNPRM* at para. 7.

[9] *See* the Cable Television Consumer Protection and Competition Act of 1992.

regulatory burdens are to be placed on the market entrant. The only constant is that in both cases exchange carriers are regulated more heavily than any other party.

A further consideration is this: Any regulation the Commission applies to VDT should be designed to encourage LECs to enter the local video distribution market using a common carrier VDT platform.

In light of injunctions against the enforcement of the Section 533(c) video programming ban, LECs now have the option to provide video programming services over closed cable systems subject to Title VI regulation.[10] If the Commission's objectives in fashioning the VDT program are to be achieved, the VDT option must be viable and likely to be pursued by exchange carriers.

Any form of regulation applied to VDT should provide LECs with the flexibility they need to adjust prices based on market competition and service demand. Thus, the appropriate question for the Commission to be asking in this proceeding is how might regulatory burdens be **minimized**. The need to consider the disincentives created by regulation is all the more apparent when administrative agencies propose regulation of markets where, but for such regulation, competition can and will take hold.

In summary: GTE suggests the Commission should decide to apply to VDT only as much regulation as necessary; and should restructure its regulatory program based on this principle. Apart from assuring no cross-subsidy -- which as shown *infra* is easily done with regulatory tools already in the FCC's hands -- the Commission can

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[10] *See* GTE's Comments in response to the Fourth Notice of Proposed Rulemaking, *D. 87-266*, March 21, 1995. at 3. *See also* GTE South, Inc. v. United States No. 94-1588-A (E.D. Va., Jan. 13, 1995).

best carry out its task by applying to VDT providers the equivalent of nondominant "streamlined regulation" contained in the Commission's Rules.[11]

3. Imposing price regulation on VDT providers -- when the service will be offered in conditions of intense competition -- conflicts with the FCC's stated policy objectives.

The offering of VDT will face intense competition from already established firms. The Commission adopted the price cap plan "to mirror the efficiency incentives found in a competitive market."[12] Here it will be the exchange carriers offering VDT that will be the "nondominant" providers of video services in local markets competing against firmly entrenched providers. There is no valid reason to impose regulation designed to "mimic" certain aspects of competitive markets when the regulated party is already facing intense competition. **Since VDT prices will be constrained by competitive market forces, "dominant" regulation of VDT is not warranted.** Imposing "dominant" regulation of VDT conflicts with the spirit of the *LEC First Report and Order*, which at para. 406 expresses an intent to refine the LEC price cap plan to "advance the goal of fostering an efficiently competitive local market" in order to "hasten the emergence of competition."

Even absent the offering of VDT, a voluminous record shows competition exists in the video distribution market. The current state of competition in that market identified by the FCC itself -- which takes account of such new entrants as VDT --

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[11] *See* 47 C.F.R. Section 61.22 *et seq.*

[12] *LEC First Report and Order* at para. 1.

warrants a more flexible treatment of VDT from the traditional price cap framework applicable to access services.[13]

There should be a substantial further stimulus to competition by the entry of LEC cable television offerings now permitted by court action holding unconstitutional the exclusion of exchange carriers from providing cable television service in their service territories. Thus, not only does a VDT provider seeking to break into an area served by a well-established cable firm face strong competition, the Commission can look forward to a dramatic increase in competition because of the foregoing factors. It makes little sense to impose heavy regulation on new entrants -- heavier than on the established firms -- just as the environment becomes more competitive.

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[13] In its *First Report* to Congress on the state of competition in the delivery of video programming, the Commission found that monopoly wireline cable systems continue to have substantial market power at the local distribution level. *Implementation of Section 19 of the Cable Television Consumer Protection Act of 1992, Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* First Report, CS-Docket No. 94-448, FCC 94-235, released September 28, 1994 ("*First Report*"). Moreover, between 1990 and 1993, cable industry subscriber penetration, average system channel capacity, the number of programming services available, cable industry revenues, expenditures on programming and capital investment all increased. *Id.* at para. 12. The Commission also found that while subscribership has not yet reached a level to conclude that vigorous rivalry currently exists in the market for multichannel video programming distribution, alternative media have made substantial strides since the Commission's *1990 Cable Report*, specifically the development of Direct Broadcast Service ("DBS") services, Multipoint Multichannel Distribution Services ("MMDS") or "wireless cable," Satellite Master Antenna Television ("SMATV") systems, not to speak of VDT services. In particular, the Commission reported that by the end of the decade, DBS operators are expected to serve from five to ten million households and that LECs would have in place VDT networks that are capable of delivering video programming to over twenty million subscribers. *Id.* at para. 25. Accordingly, the Commission concluded that "the outlook for improved market performance in multichannel video programming distribution markets as a consequence of increasing competitive rivalry remains promising." *Id.* at para. 246.

As the Commission's *First Report* assessment demonstrates, consumers will have access to an increasing number of alternative video suppliers in coming years and will be especially sensitive to price and quality changes. Further, the development of technologies such as digital compression will significantly increase the potential capacity of both VDT and traditional cable services to serve increasing demand for basic video, video-on-demand, and advanced interactive services.

Given these considerations, it is putting it mildly to say VDT providers will not be able to exercise unilateral market power in the local video distribution market. This again indicates VDT should be subject to the equivalent of streamlined regulation.[14]

In summary: The Commission's own findings and policy objectives dictate "streamlined" regulation of VDT providers seeking to enter a market where a cable television firm is already established.

4. Ample protections already exist against any risk of predatory pricing.

Predatory pricing occurs when a firm sets prices "below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run."[15] Predatory pricing requires that: (i) the predator be a dominant firm; (ii) the structure of the market allow later recoupment of the funds

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[14] The Commission, using many of these same market factors, reached the conclusion that commercial services provided by AT&T should be removed from price caps and be made subject to streamlined regulation. *AT&T Price Cap Report and Order.*

[15] Cargill, Inc. v. Montfort of Colorado, Inc., 479 U.S. 104, 117 (1986), footnote omitted.

invested; and (iii) the predator invest in the elimination of its competitor.[16] In the highly competitive market for video services that will be assured by aggressive VDT entry, these elements are impractical.

In furnishing VDT, exchange carriers will be in direct competition with cable and broadcast satellite network services. The providers of these services have facilities in place and a solid customer base. In such an environment, the LECs as new entrants would not be dominant, and so could not be confident of recouping the losses sustained from predation.

Further, exchange carriers are subject to close antitrust scrutiny as well as regulatory scrutiny at both state and federal levels.

Nonetheless, the *Further Notice* maintains regulation is required to avoid the "improper cross-subsidization by preventing local telephone companies from offsetting a price reduction for video dialtone service with an increase in rates for other regulated interstate services."[17] But the governing principle on cross-subsidy questions the need for restrictions beyond what already exists:

> [A] service is cross-subsidized if the incremental revenue from provision of a service at current prices falls short of the incremental cost of providing the service at its current volume, taking into account demand cross-elasticities and cost-complementaries.[18]

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[16] *See, D. 94-1*, GTE's Comments, dated May 9, 1994, Attachment F, Schmalensee, Richard and William Taylor, "Comments on the USTA Pricing Flexibility Proposal," ("*Schmalensee and Taylor*") at 14.

[17] *FNPRM* at para. 2.

[18] *Schmalensee and Taylor* at 16.

In establishing the original price cap baskets, the Commission sought to limit LEC ability to engage in anti-competitive cross-subsidization, that is, from shifting costs from services for which they face relatively high competition to services for which they face little competition.[19] Not only do exchange carriers face a heavily competitive environment for VDT; the potential sources of any "cross-subsidy", such as interstate access, are not only competitive but closely price-controlled through the price caps program and detailed FCC scrutiny of LEC accounting[20] and LEC tariffs.[21] This eliminates the possibility of the exchange carrier's raising prices of other interstate access services to a level that could offset low prices for VDT.

Further, interstate VDT could not be cross-subsidized by intrastate services since all these services are regulated by the states. Indeed, the Commission recently affirmed that none of its actions preempt the state commissions from disallowing any VDT-related costs in setting intrastate rates.[22] And the FCC retains the ability to review and reject tariffs for streamlined services -- which gives the Commission a "back-up"

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19 *LEC Price Cap Order*, 5 FCC Rcd at 6811.

20 Over and above generally applicable accounting requirements, the FCC has imposed on VDT providers extensive accounting and reporting obligations designed to prevent cross-subsidy. Thus, exchange carriers offering VDT are required to: (i) account for VDT investments, expenses and revenues in subsidiary accounts, (ii) amend Part 64 cost allocation manuals to reflect the treatment of any non-regulated services provided over VDT, and (iii) submit detailed explanationss of how they are applying the Part 36 rules to VDT investments and expenses. *VDT Reconsideration Order* at paras. 173, 181 and 189.

21 Indeed, LEC upward flexibility originally afforded by the price cap indexes has been severely reduced by the *LEC First Report and Order* at paras. 200, 247-248, 309 and 330, as well as n. 20.

22 *VDT Reconsideration Order* at para. 191.

power to be sure LECs have not priced VDT below the relevant predation safeguard, its incremental cost.

In summary: VDT should be treated as what it is, a highly competitive service. GTE urges the Commission to conclude in this proceeding that a VDT provider entering a market served by an established cable television firm should be subject only to streamlined "nondominant" regulation.

II. IF THE COMMISSION INSISTS ON "DOMINANT" REGULATION OF VDT OFFERINGS, IT SHOULD BE STRUCTURED TO AVOID UNNECESSARY BURDENS, AND TO PERMIT VDT PROVIDERS TO COMPETE WITH ESTABLISHED CABLE FIRMS.

1. To have viable and competitive VDT offerings, the best approach would be price caps with a separate basket and no service categories, and with the Part 69 waiver requirement eliminated.

The *Further Notice* (at para. 8) requests comment on whether the creation of a VDT service basket would further the Commission's VDT objectives of facilitating competition in the provision of video services, promoting efficient investment in the national telecommunications infrastructure, and fostering the availability of new and diverse video programming to the public. It also asks whether the creation of a VDT service basket would further the price cap goals of promoting economic efficiency, ensuring reasonable nondiscriminatory rates, and reducing administrative costs.

A price cap model for VDT will only meet these objectives if it is designed in such a manner that it encourages LECs to enter the local video distribution market using a common carrier VDT platform and provides LECs with the needed flexibility to adjust prices based on market competition and service demand. The Commission has concluded that regulatory flexibility "is key if video dialtone is to develop in accordance with market needs and technological innovations rather than according to Commission mandate. Moreover, we clarify that regulatory flexibility encompasses the elimination of federal regulatory barriers to the extent the public interest would be served thereby."[23]

It is critically important that the Commission adhere to this primary objective if it is to insure that video dialtone evolves as a true alternative to closed monopoly cable offerings in the video distribution markets. This means exchange carriers must be afforded the flexibility to design VDT service offerings that will enable programmer-customers to compete with entrenched cable operators. LECs will only be willing to invest in the construction and expansion of VDT infrastructure and technology if they can expect to attract a sufficient number of programmers to purchase capacity on their VDT systems. In turn, end user subscribers will not subscribe to a VDT programmer's service package unless they are competitively priced *vis-a-vis* the existing cable operator's service offerings. The Commission's overall VDT policy objectives will only be met if rates for LEC VDT services are not constrained by artificial pricing constraints.

To the extent that the Commission believes that price cap regulation of VDT services is necessary, a separate price cap basket for VDT should be established. Further, a separate price cap basket, if free from subelement pricing constraints, would enable LECs to implement efficient pricing structures, and would provide the flexibility to adjust rates to fit market conditions.

In contrast, there is no basis for including VDT in other service category baskets. VDT differs from traditional access services with respect to technology, services provided, customer base and competition. Many VDT networks will deploy new

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[23] *VDT Second Report*, 7 FCC Rcd at 5805.

technologies such as Asymmetric Digital Subscriber Line ("ADSL"), video servers, video switching, and digital compression -- technologies that are not currently deployed in the provision of access services. The fundamental services furnished over VDT networks will be structured in such a way to accommodate a diverse set of programmer needs. Therefore, tariffs for VDT may contain a variety of rate elements to accommodate functions such as basic analog or digital video transport, video-on-demand, digital interactive capabilities, compression, and reception functions. Clearly, these VDT service offerings are not consistent with the local access functions within the existing trunking and local switching baskets.

Services provided over VDT will also compete with entirely different customer sets. VDT transport and related services will be provided to Multichannel Video Program Distributors ("MVPDs"), specialized program packagers, video-on-demand providers and enhanced interactive service suppliers. End user customers will be able to freely access any of these providers using the VDT system by the means of menus and video gateways, often by a "click" of their remote control.

Finally, the competitive characteristics of VDT are unique. Programmers using GTE's networks will be soliciting customers that, in most cases, previously had no choice in their selection of multichannel video services provider. Exchange carrier VDT systems will be starting from a customer base of zero and will be required to compete with an entrenched cable operator that controls substantial market power at the local distribution level. Based on these characteristics, the Commission should refrain from including VDT services in existing price cap baskets.

The Commission has also requested comment on whether further subdivision of a VDT services basket is necessary or desirable. The Commission should not mandate specific pricing elements for VDT nor should it limit the LEC's ability to construct a competitive service offering by constraining VDT prices and rate structures through requiring specific sub-categories and pricing limits.

The *VDT Reconsideration Order* (at para. 196), because VDT is a nascent service, and given the wide variety possible network architectures, finds "that there is a significant risk that any uniform rate structure we would prescribe now would fail to produce rate elements that logically match each carrier's video dialtone offering." Indeed, a review of illustrative tariffs submitted with various LEC's Section 214 applications, as well as Part 69 waivers and tariffs filed to date, reveal dramatic differences in underlying rate structures and applications among VDT offerings. These differences are not accidental. In order to be successful, LECs have designed VDT service offerings that accommodate the needs of their individual markets and reflect the underlying technologies and network architectures employed. The prescription of specific rate categories would conflict with the structures proposed in many of the LEC's pending (and approved) Section 214 applications and could force exchange carriers to make substantial structural changes to their VDT plans.

VDT service offerings must be designed in a manner that will enable customer-programmers to compete with entrenched cable operators. This cannot be done if the rates for VDT are bounded by artificial pricing constraints. The imposition of upper and lower pricing constraints on VDT prices would needlessly impose costs on consumers to the extent that it would deny the LEC flexibility it needs to react to market conditions and customer demands. The decision by a programmer to enter a local video distribution market will be based, in part, on its underlying transport costs and its ability to price programming services to consumers in a manner that is competitive with alternative cable system rates. If GTE is restricted in adjusting its VDT transport levels, VDT programmers could be further constrained from providing viable alternatives to existing cable system and DBS offerings, thus depriving consumers of the benefits of price competition for video programming services.

Finally, the *VDT Reconsideration Order* (at para. 197) (i) determined that VDT services would be treated on an interim basis as switched access services and (ii) required exchange carriers to submit Part 69 waiver requests. To the extent the Commission determines that a separate price cap basket is necessary for VDT, it should eliminate the application of the current Part 69 rules to VDT service, including the requirement to file waiver petitions.

The Commission's Part 69 rules were originally intended to regulate LEC control of interexchange carrier access to local telephone switched distribution facilities in an environment of only very limited local access competition. Now, the existing Part 69 rules are entirely the wrong regulatory construct to apply to LECs as new entrants attempting to compete in what will become a fiercely competitive video distribution market. The continuation of Part 69 waiver proceedings will only duplicate existing tariff procedures that permit a thorough evaluation of proposed VDT rate structures and cost assignments. Thus, there is no public interest benefit to be gained from requiring LECs to submit descriptions of rate structures and expected cost assignments prior to filing an actual tariff for VDT service.

The current Part 69 waiver requirement also needlessly delays the regulatory process for VDT. A process that requires new market entrants to engage in one lengthy regulatory proceeding after another to introduce a new service based on new technology will not produce a genuinely competitive market. Customers of VDT networks will simply not wait for the completion of a series of time-consuming Commission actions before choosing the supplier they will use to deliver their services to the market. If a LEC has obtained Section 214 approval for a commercial VDT service and has programmers ready and willing to provide alternative video services to local consumers, the company should be not forced to delay the filing of a tariff pending a grant of its waiver request. Therefore, once a new price cap basket is established for VDT, the Commission should eliminate its Part 69 waiver requirement.

In summary: If price caps regulation is applied to VDT, it should be with a separate basket and no service categories, and with the Part 69 waiver requirement eliminated.

2. The initial cap for VDT should be set using the "new services" rules and should immediately be subject to the price cap formula.

The *Further Notice* (at para. 18) tentatively concludes that the best approach to establishing the initial VDT rates would be to apply the existing price cap rules for new services. As the Commission has previously held, the new service test sufficiently guards against predatory pricing while providing a flexible approach in setting rates that must be competitive in the market.[24]

In the *VDT Reconsideration Order* (at paras. 217-220), the Commission provided additional guidance on the types of cost and expenses that should properly be reflected in setting initial rates for VDT service. GTE agrees that VDT charges should reflect a reasonable amount of shared cost and overhead expenses incurred by the company. However, the Commission should not establish a more stringent standard for the

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[24] *VDT Reconsideration Order* at paras. 204-213.

setting of initial VDT rates than that applied to other services. Initial rates for VDT transport must be set such that programmers can afford to offer a service package to consumers that competes with the basic cable offering in the area. If exchange carriers are forced by Commission policy to establish rates that are set at uneconomical levels relative to the existing market, VDT offerings will not attract a sufficient number of programmers and could ultimately fail.[25]

Once rates are established under new services test, the VDT price cap index should be set to a value of 100 and VDT should be subject to the constraints of the price cap formula immediately. LECs must have flexibility to adjust rates on short notice to meet cable operator's initial reaction to a new market entrant during the period of initial VDT implementation. Waiting until the next annual filing to incorporate new VDT rates under price caps will require LECs to make any interim rate adjustments on a statutory 45 day notice period, which could be extended to 120 days. Simply put, LECs cannot sustain such a delay in filing competitive rate responses. Once initial prices are in place, exchange carriers should be able to adjust rates on 14 days notice. Any appropriate index adjustments; *i.e.*, GDPPI, can be made at next annual filing.

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[25] Consequently, faced with overly-restrictive pricing rules, LECs may alternatively choose to abandon the common carrier video model and elect to become cable operators under Title VI. While this election would also provide an additional competitor to existing closed cable systems, it departs from the Commission's VDT vision of promoting diversity in the type and quantity of video programming available to the public.

3. The productivity factor should be set at the same level as for the cable industry: zero.

The Commission should follow its own precedent in establishing a productivity factor for a VDT basket at zero for these reasons:

First, the Commission "concluded that the record did not provide an adequate factual basis for the incorporation for a productivity offset in the price cap governing cable service rates."[26] None of the available studies on LEC productivity incorporate the provision of VDT; therefore the Commission has no record on which to determine LEC productivity for the provision of VDT service. Lacking such a record, the Commission should establish the same factor for the LECs' VDT basket as it did for the cable industry -- zero.

Second, in the *LEC Price Cap Order*, the Commission set a precedent for a different productivity factor for a basket by establishing a different productivity factor for the interexchange basket based on its conclusion that the LECs interexchange services would compete with those of AT&T. Thus, the Commission established the same productivity factor for the interexchange basket as that used by AT&T, 3.0 percent.[27] The Commission further reinforced this in the *LEC First Report and Order* and maintained the 3.0 percent productivity factor for the interexchange basket although changing the productivity factor for the other baskets.[28]

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[26] *See* FNPRM at n. 40.

[27] *See LEC Price Cap Order* at 6811.

[28] *See LEC First Report and Order* at para. 249.

This same reasoning should hold true for a VDT basket. The exchange carriers will be in direct competition with cable providers with a productivity factor of zero. To assess the LECs a higher productivity factor than their entrenched competitors would defeat the Commission's goal of promoting effective competition.

The Further Notice (at para. 14) states that it wants to select a factor that would be efficient and fair to the LECs, their customers, and consumers. Setting the productivity factor for the VDT basket the same as the cable industry's would be fair to the LECs and would allow them the necessary flexibility to adjust their prices to meet competition -- which can be expected to provide maximum benefits to customers and consumers. In short, it establishes regulatory parity between the LECs and the cable industry as the Commission did between the LECs and AT&T in the interexchange basket. This includes the Consumer Productivity Dividend ("CPD"). Adding a CPD to any LEC's productivity factor established for a VDT basket when it is not in the cable industry's price cap plan would introduce an asymmetric element that would prevent creating the competitive environment sought by the Commission.

The *FNPRM*'s expressed concern (at para. 14) that a low productivity factor would result in too high prices flies in the face of the whole concept of a competitive market. In a competitive environment, the marketplace sets the prices. In a competitive market, no principle of sound regulation calls for continuing governmental intervention by mandating price decreases by one of the competitors. Facing entrenched competitors, the LECs will have to price competitively if they are going to succeed.

In summary: The Commission has established a productivity factor of zero for the cable industry. GTE urges the Commission to follow this precedent and establish a productivity factor of zero for the VDT basket.

Respectfully submitted,

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April 17, 1995

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Certificate of Service

I, Ann D. Berkowitz, hereby certify that copies of the foregoing "GTE's Comments" have been mailed by first class United States mail, postage prepaid, on the 17th day of April, 1995 to all parties of record.

Ann D. Berkowitz